

AviationAdvocacy

Low Cost Interlining

Suddenly, the phony war on the next wave of airline development is over. The recent announcements: Air Berlin taking over LTU; GoL buying Varig in Brazil; RyanAir announcing a new long haul low cost carrier; AirAsiaX starting operations in Malaysia; starts the real war. The recent EU-US bilateral agreement may have been stealing the headlines, but with, our without, that development, airline executives have been thinking for some time about what the airline of the future might look like. Let's get one thing clear. All carriers are now 'low cost'. Show me an airline that wants high costs. The distinction is about input costs; and more specifically, it is about the amount of historical baggage the airline carries. The battle is between new entrants and legacy carriers.

It is not a battle between short haul carriers and long haul carriers. There have always been low cost long haul carriers: step forward the charter airlines that have been flying passengers to long haul holiday destinations around the world for decades. They do so, on the cheap, with very few frills. Rather like their newer, short haul cousins. In both long haul and short haul, in-flight amenities have improved somewhat over time. RyanAir might soon have mobile phone connectivity (even if from RyanAir's perspective this is only to increase ancillary revenue, from the passenger perspective, it is an additional amenity), JetBlue has in-seat television, Oasis Hong Kong has quality meals and in seat video. That has been happening for a long time.

What has never happened before is an airline with a very successful short haul network model – almost certainly developed using a fairly constant playbook: one aircraft type; no interconnection services whatsoever; point to point only; the establishment of an airport operating as a central point with spokes working outwards (it is hard to call it a 'hub' in the traditional sense, in that as noted above, there are no interconnection services) – joining up its no frills short haul network and a no frills long haul network, to build a new style, non-legacy network carrier.

In other words, the LCCs must now start to think hard about the issues in perhaps the only area that to-date the full service, national, legacy carriers have had the upper hand: interlining; the ability for an airline to transfer passengers seamlessly from one flight to another. Long haul carriers need interlining to bring passengers from a number of close destinations to a single hub airport for transfer onto a large long haul aircraft. For the legacy carriers, about to introduce the new 747-8 and or the A380 interlining will be as important as ever. Few cities can generate the 500 passengers per flight departure necessary to fill these aircraft to each long haul destination being served, but 25 cities might generate 20 passengers each, filling the aircraft.

RyanAir has been vocal in saying that it will not have interlining, but these are early days in RyanAir's planning. Air Berlin/LTU and GoL/Varig have both not ruled it out at all. AirAsiaX is on the record as saying that it cannot think of a way to make it work. There might be economic imperatives that mean that in all these cases, they need to find a way to do so. The economics of the low cost, short haul phenomenon has been analysed to death; there is a dependence on high frequency, point to point markets, using the simplest of services possible.

In the long haul market, a few different economic factors need to come into the mix. First, for the long haul sectors, longer range aircraft are needed. These are usually larger, calling for more passengers per aircraft, but given the flying times the aircraft do fewer flights per day. Furthermore, as the sector length increases, the comparative advantage of fast ramp turnaround times diminishes, relative to the aircraft utilisation. Coupled with that, operating a point to point service between two distant points, without harnessing the benefit of the huge networks most of the LCC carriers looking at this have (RyanAir in Europe, Air Asia in Asia) would be simply crazy.

Historically, the long haul aircraft departed from major cities, with significant origin traffic (such as London, Tokyo, Hong Kong) but they also relied on the hubbing of services into the airport. New entrant carriers, with their low cost model, have drained a percentage of the point to point traffic from a number of these city pairs. What the new entrant carriers have also done is create new markets to regional airports. But can those regional airports sustain such long haul traffic, or the network interactions necessary to fill the big long haul aircraft?

What has been keeping several legacy carriers in the game is that their passengers appreciate the relatively seamless transfer onto long haul flights through the big traditional airports, particularly in the business market. The legacy carriers are constantly upgrading their lounges accordingly. If the new entrant carriers start joining up their short haul and long haul networks another day dawns. That is why these new tie ups are so interesting, both for airlines and for airports.

Interlining has a cost. An interline ticket is more complex. The baggage transfer issues multiply. Not only must the bag get from check-in to the aircraft, but now someone from the airline must make sure that it gets from one aircraft to another. That calls for systems for multi-sector baggage check-in. What happens should the bag miss the connection? What happens if the passenger misses the connection? One of the great innovations of SouthWest was to break down the hub and spoke mentality of the legacy carriers, inverting the then common understanding that aircraft wait for passengers. At SouthWest, passengers wait for aircraft (and do their own baggage transfers). Will that expectation take hold with long haul, international flights as well? Is the price one pays for a low cost ticket the price of self-interlining?

Legacy carriers have the advantage of the years of patient and meticulous work that IATA has done to ensure that the systems and the processes necessary to transfer passengers and baggage work. It is arguable that in the interline system the airlines created one of the great intellectual property assets in the history of the world. Within the IATA interline systems it is possible to buy a ticket to and from any airport served by IATA's members (not just your own airline) in one currency, with one ticket, check in your luggage and pick it up when you get there. When you think about it, it is remarkable. And with the introduction of bar codes and soon RFID, the legacy carriers continue to work on improving the system.

However, the system has been under pressure since the anti-trust regulators dug their heels in opposing one of its fundamental tenants, that to transfer a passenger onto another airline it was necessary to know what to charge. (Telecom companies do their own brand of interlining seamlessly too, not to mention the energy sector or the banking industry. But significantly, they get paid in arrears for their services. Airlines charge their customers in advance.) Airlines worked out their interline fares by sitting in an IATA convened room (there has never been evidence of a smoke machine) and agreeing together what those prices should be.

At the same time, it also required IATA's members to agree, and use, the same ticket formats, bag tag processes, delayed passenger connection protocols and so forth. All these systems cost money to purchase and maintain. These are the sort of legacy things that the new entrants did not need to subscribe to, at a significant cost saving.

The breakdown in the interline system has not opposed as forcefully as it should have been when it first came under attack, because the big airlines saw an advantage in pretending that instead of general, all carrier interlining, passengers could be focussed on using the same processes – only now inside their (anti-trust immunised) alliances. The system is therefore splintering. For many decades, the US DoT, the EC and the ACCC in Australia authorised these processes, but that is increasingly not the case today. It is particularly not the case for the agreement on tariffs and rates.

Increasingly, only the underlying operational systems and processes remain, but, they are expensive. The legacy of the interline system has been that to operate an airline that had some interline passengers on each flight, it was necessary to have check-in facilities, bag sorting facilities and other systems that would support those few interlining passengers, so they were made available for all the passengers on the flight. That is one of the huge savings that new entrant carriers have been able to make.

The challenge for the new entrants is to now find a way to do this at less cost than the legacy systems. Expectations are lower of course. Years of conditioning has seen to that; no one travelling on Ryan Air expects any sympathy at all should a connection be lost. But it is important to remember even RyanAir is talking about a business class service level on the long haul services. Either their customer service ethos is going to be upgraded, or more likely, customers were going to find new levels of self sufficiency within a framework of rebuilding, from the ground up, some sort of interline infrastructure.

At the same time, security upgrade requirements that all airlines face are working in favour of low cost interlining too. It is getting harder and harder for passengers to travel without their luggage so that if there is missed connection, there is a growing requirement for rapid baggage reconciliation, or other processes to take effect.

That brings us back to the issue of airports. Designing and installing new, streamlined infrastructure is more likely in a small airport, where there are no parallel demands for 'full service' legacy interlining facilities. In other words, that is more likely at regional airports. More likely, and, more necessary.

Aviation Advocacy has spent considerable time working on the steps necessary for a streamlined, no frills interlining service. It will call for work on a contractual level, within the airport and may have system implications. However, it is our view that it is possible, and that there are considerable prizes to the new entrant carrier that develops such a system. Aviation Advocacy is available to discuss this on request.